

DOW THEORY LETTERS INC.

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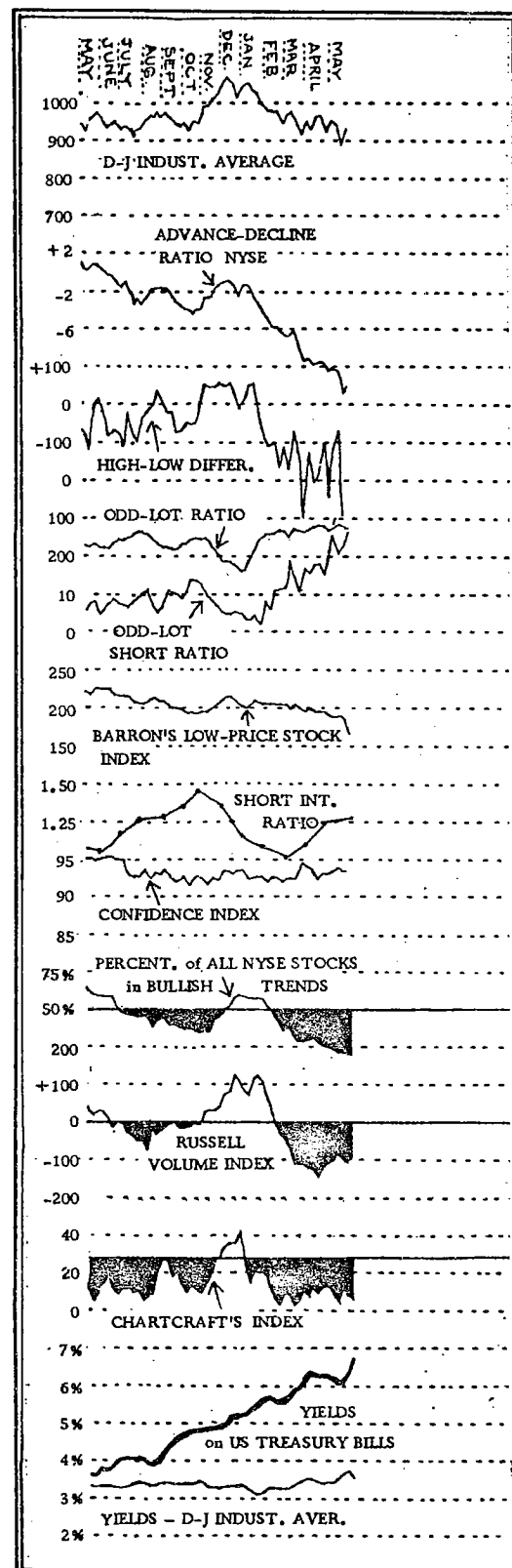
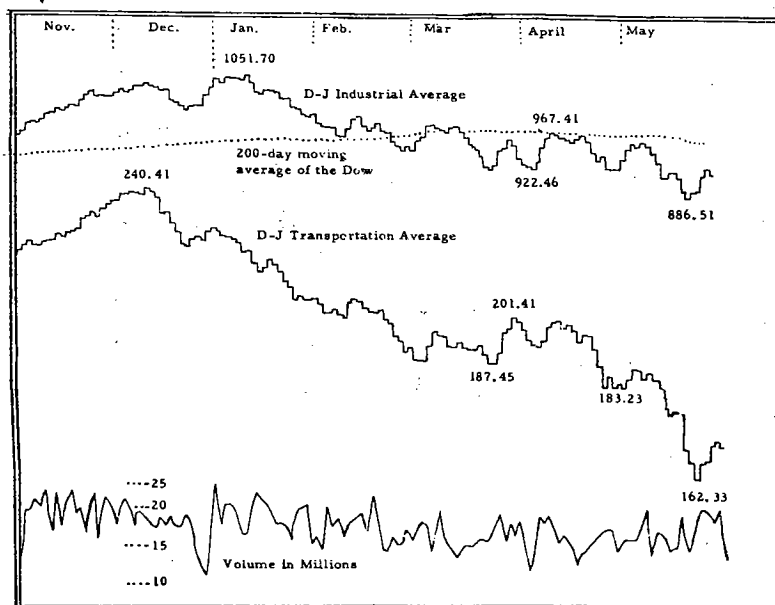
May 18, DJIA 895.17, PTI 773, A-D ratio -12.74
May 25, DJIA 930.84, PTI 785, A-D ratio -12.36

THE PICTURE: With the correction which is taking place in the gold shares, I feel that this provides us with an excellent opportunity to examine the entire gold picture from the standpoint of history, value, meaning and price action. I am going to publish the "gold picture" in a two-part series, the first of which is included in this mailing. As I see it, the gold shares represent the only stock group now in a major or primary bull market (golds are, of course, counter-cyclical). This implies, obviously, that I consider the rest of Wall Street to be in a primary bear market.

As to timing, I would guess that the full story for gold and the rest of the market might not be told until late-1974 but more probably not until 1975 or 1976. Thus, I believe that positions in gold will require the usual great patience before the real profits are in order (and I know that many of my subscribers have big profits in golds now). And I also realize that the majority of common stocks will be smashed to very low levels before this bear market breathes its last sometime in the next one to three years.

If any readers believe that I am "enjoying" the gold move, forget it. The current gold picture is part of a gathering tragedy which has already seeped into every segment of American life. When politicians cut the dollar loose from gold, they left the dollar to float like a ship without an anchor, to erode in value thereby wiping out the savings of millions of people. Those who sold bonds were then to all purposes "selling the dollar short," since they were borrowing current dollars with the promise of paying off with cheaper dollars. It was the politics of greed and perhaps in today's Watergate affair we can see the corruption, cynicism and grubbiness which has crept into the land. Two thousand years ago a rabbi out of Galilee warned the world, "Watch out, and guard yourself from all kinds of greed; for a man's true life is not made up of the thing he owns, no matter how rich he may be."

WALL STREET: As can be seen on the page 1 chart, the Dow on May 24 bounded 29.42 points, thereby putting Industrials above the 920 level again.



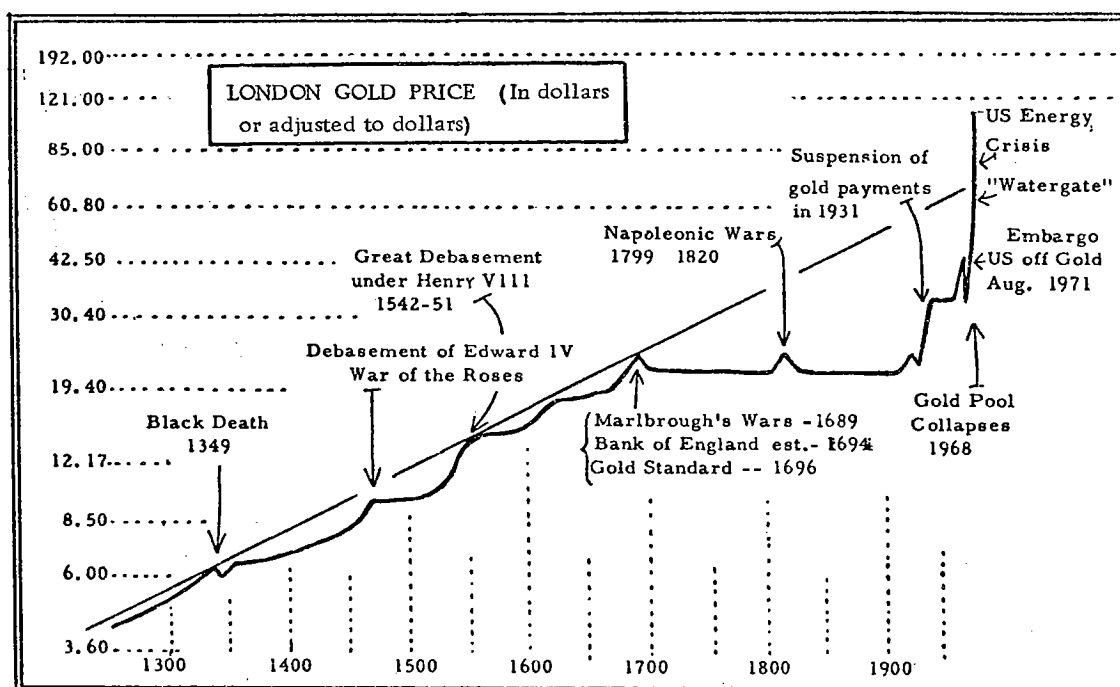
Page 2 The rise from the May 21 lows saw Transports keep up with Industrials in terms of percentages, and the investment fraternity (which has been shouting "oversold" ever since February) took the late-May rise as the beginning of an important upward move.

As readers know, I have been saying that by "ordinary standards," this market has been overdue for a corrective rally for the past few months. But during primary bear markets, the market (unfortunately) may stay "oversold" for many weeks or even months, and this is obviously what has occurred during 1973. A factor to consider is that most major "bottoms" of the past decade have developed in the following manner: The Averages (Industrials and Transports) drop to lows on high volume, a rally takes place, following which the Averages again decline with one or both of the indicators then breaking below the preceding lows. At the second lows (which often occur a month or so after the first set of lows) panic conditions may reign, with odd-lot shorts soaring, many favorite stocks (and hold-outs) collapsing, and the majority of Wall Street commentators turning stony bearish on the entire scene. This is the kind of situation which we could now be preparing for. If and when a second bottom occurs, I would expect the rise to be more impressive than if it stems directly from the current "V bottom" as seen on the page 1 chart.

The next question is, if May 21 represented a good bottom for an important upward correction, then what? My answer is that as far as my Dow Theory procedure is concerned, we will avoid buying into bear market rallies. This kind of scalping or "in-and-out" trading can seem exciting and even profitable for a while. My experience with it, however, is that in time the amateur (and by amateur I mean non-floor traders) emerges poorer and occasionally even wiser. But as veteran readers know, I do not advocate the average investor trying to beat a bear market with stocks, regardless of whether he is lucky enough to catch a few important rallies or not. We have had quite a number of fat Dow rallies since the bear market started in 1966, and the public is leaving Wall Street in droves. Why are they being so inconsiderate? Simply because they have tended to lose their shirts since the 1966 highs. It's as simple as that, despite the fact that the Street tells itself that high commissions, institutional "take-over" of the markets, low yields, etc., have been the culprits. The truth is that if the public had made money in stocks following 1966, nothing would keep them out of the Street today, and I repeat — NOTHING!

GOLD: Everyone knows the story of the gold "expert" who was asked about the yellow metal. "There are only two men in the world who truly know gold," was his answer, "One is a clerk in the Bank of Rothschild and the other is an economist for the British government. Unfortunately, they don't agree."

Well, it's really not as bad as that, but the problem with understanding gold (as I have so often written) is emotional. Men don't want a stern master, an outside force which exerts a discipline on their hunger for power. Yet, that is exactly what gold does. In the "old days" when the dollar was literally "as good as gold," if the US government started embarking on an inflationary policy, men would do more than worry about their paper dollars. They would take their dollars to the bank and turn them in for gold. When enough citizens did this (or if there was enough foreign selling of dollars for gold), this would constitute "a run on the banks." Deposits would collapse, a "panic" would be on, and in short order deflation would take over. This is one way that gold thwarted power-hungry (or perhaps well meaning but inflation-minded) politicians. A run on gold could always be counted on to defeat inflation.



In 1934 the right of US citizens to own gold was removed (the Gold Reserve Act). Around that time, no doubt, many men sorrowfully eyed George Bernard Shaw's advice regarding faith in the politicians or faith in gold. I reproduce that little thought for those who have never seen it.

I spent part of the weekend constructing an historical chart (page 2) which offers a few items that most of Washington, the Treasury, the Federal Reserve Board and perhaps even a few subscribers have never considered. It is a concise little history of gold going back to around the year 1250 (this is undoubtedly my longest "long-term chart"). Now understand one thing, this is not an arithmetic chart, this is a ratio or semi-logarithmic chart. The gold movements are shown in percentages. Thus, a rise from around \$3.80 in the year 1250 to the \$6.10 price which existed during the dreaded years of the Black Death (the "plague" wiped out one-third of Europe's population) represents a jump of about 33%. That 33% will show on the chart as the exact same distance as a rise from \$50 to \$80, a change which is also equal to a 33% rise.

"You have to choose between trusting to the natural stability of gold, and the honesty and intelligence of members of the government. And with due respect for these gentlemen, I would advise you, as long as the capitalistic system lasts, to vote for gold."

Notice that from the year 1250 to around 1700 gold rose at a fairly even rate (as measured by the rising trendline on the chart). From 1700 to the early 1900's there was an extended period in which gold held relatively stable. During the 1930's the Keynesian philosophy gained wide acceptance, and a bastardized form of Keynesianism became a deliberate policy of the US government ("run big deficits during bad times, run deficits during good times").

With the deficit dollars piling up, pressure began to mount against the gold price. The "Gold Pool" of the 1960's, formed to manipulate the gold price to a steady \$35 per ounce (while dollars were printed in carload lots), collapsed in 1968. The rest is current history. In 1971 the US closed the gold window and paper money continued to pile up in the coffers of the US's creditors. Then came the two dollar devaluations, the "energy crisis," "Watergate," and still the dollars poured off the presses.

When I say "poured," I am hardly exaggerating. For example, when Mr. Nixon took office during 1969 the money supply in the US was \$190 billion. Today it is \$258 billion, up \$68 billion in four years or \$17 billion a year, \$46 million a day, \$2 million an hour! And all history, remember, teaches us that when "legal tender" money is debased men turn to real money—gold.

Many say that when gold started climbing above the \$70 level in August, 1972, it was "taking leave of its senses." But when we realize that there are now well upwards of 100 billion overseas dollars searching for a safe haven, the probability is strong that the gold rise represents a move towards reality. The reality is simply that the dollar (via deficits and inflation) is being systematically destroyed. The old adage goes, "When everyone is rushing around in a panic — and you find yourself calm and collected, better recheck your thinking. You're probably missing something!" That, in a nutshell, is the position that the non-holder of gold or gold shares finds himself in today.

If anyone could fully comprehend the meaning of the accompanying long-term gold chart, he could probably solve the world's monetary problems. For a glance at the chart shows one frightening item. The current rise is the greatest percentage advance in the history of gold as measured in terms of the US dollar. And the reason for the rise is obvious. There has never been a time where so much reserve currency (well over \$100 billion) was searching so frantically for intrinsic value (gold). Thus, we are probably seeing the greatest and fastest debasement of a major currency in history.

In early 1973, an unusual event occurred. In response to a dollar that was collapsing so fast it could not be supported by any amount of manipulation the major nations decided to "float" their currencies against the dollar. This multi-float spelled the end for the currency speculator and the investor who wanted to hedge his assets. No longer could they move from a weak currency to the safety of a stronger one, since the float meant that all currencies were continually adjusting to one another with no fixed parity. From that point on, gold alone constituted the hedge against weakening paper currencies (regardless of which currency was weakening).

On April 1, 1973, Japan changed its laws to allow its citizens to own gold. In the month of April Japanese citizens purchased 90 tons of gold. At this rate (which amounts to over \$1 billion per year) the Free World's supply of around 1250 tons of gold (plus any Russian sales) would not be enough to supply artistic, industrial and hoarding desires without massive new increases in the gold price. At the same time the Senate introduced a bill which would allow US citizens to own gold. As I see it, US citizens will not be given this right until after the dollar is made convertible into gold at some high price level. If US citizens were allowed to own gold now, they would (in my opinion) hedge their inflation fears by buying up gold in huge quantities, driving it to over \$200 per ounce within a month.

(1) Gold has been considered desirable since prehistoric times. Men have spent their lives searching for it; some have lived for it, many have died for it. (2) For those of religious bent, gold is the first metal to be mentioned in the Bible (mentioned before the "fall" of man). In Genesis 2:12 (speaking of the land of Eden) we read, "And the gold of that land is good." (3) Gold lasts "forever." It does not rust, tarnish or corrode. It can be re-used countless times. The gold ring you are wearing might have been reworked from a coin minted under Alexander the Great. (4) Gold is the most malleable and ductile of all metals. Gold has been hammered into sheets 1/250,000 inch thick. An ounce of gold has been stretched into an unbroken wire 35 miles long. (5) Gold is a superb conductor of electricity. (6) Gold, unlike diamonds, can be melted into any shape while retaining its intrinsic value. Unlike valuable (and often identifiable) precious gems, gold is "anonymous." (7) Gold will always remain scarce. All the gold ever mined would just about fill one large country barn. (8) Gold is astonishingly heavy and pleasing to the touch (a cubic foot of gold would weigh half a ton!). (9) Gold possesses outstanding beauty and a deep luster which makes it ideal for jewelry.

So much for gold's intrinsic and historical value. The question is asked, "Why is the price rise in gold bullion so explosive, so insistent, and so reluctant to correct, when the gold shares themselves (in most cases) appear so much more moderate in their advance and so prone to violent profit-taking?

My answer is this: Americans are forbidden by law to own gold, but they are allowed to own gold shares. The "big money," the international investors, the overseas governments who understand gold — they have turned to the primary market, the gold itself. The reason gold bullion is so high priced and so reluctant to correct is that the big money is not taking profits. They are probably thinking in terms of gold bullion at much, much higher prices. Gold shares are the "second class" entry into the gold picture, at least at this point. Americans, who pretty much move the gold share market, do not really understand gold at this time, nor do they have the faith in gold shared by say the Arabs, the Swiss, the French or the Japanese. Therefore, everytime a gold share runs up a few points, the skeptical US holder runs to take "a profit." Thus, the gold shares correct and move up hesitatingly, while the price of gold bullion climbs like a rocket and holds like a rock.

My question: If you were an Arab Sheik, would you put your next million into gold shares (with potential worries about labor, costs, taxes, variable government's policies, etc.) or would you buy the yellow metal itself? Now mind you, I am not knocking the gold shares. But I am saying that they are the "second best" investment after gold. Ultimately, they may go up higher than gold in terms of percentages. But basically big money moves gold, the masses move into gold shares (and most other shares). If gold bullion goes to \$500 to \$1000 per ounce, it will be powerful investment money that will take it there. If Campbell Red Lake goes to \$200, it will be thousands of investors on Wall Street who will do it.

I have noticed that the public often follows "investment or big money" by about six months to a year. In other words, a stock under investment accumulation will make an initial rise, then six months to a year later the public will come in and "carry the ball." The public seems to require that much time before seeing the picture, aided by the excitement of the initial "investment rally." I consider that the real excitement in the bullion price of gold began with the February-May, 1973 gold explosion which took the price of gold from the low 60's to over 100. If my timing is anywhere near correct, it will be late-1973 into 1974 before the public (which can only buy gold shares, not the bullion) will be willing to pile into the gold share market with anything like enthusiasm. At the moment, there still remains great skepticism about the "authenticity" of the gold bullion price rise as well as the reality of the movement of gold shares.

JOHANNESBURG. South Africa (AP) — When free market gold soared above \$100 an ounce, South Africans began sinking shafts for new mines and stretching the life of older ones.

Unused mines may be re-opened and some mining firms are merging to pool their resources for more digging. Advanced technological methods will be used to examine apparently played-out mines.

OUTLOOK BRIGHTENS

Robert C. J. Goode, president of the Chamber of Mines, said that last year the industry's trade organization expected an increase to \$120 an ounce by 1987, and "ever since we made the forecast it has been looking more and more conservative.

Meanwhile, the new high price of gold is exerting outstanding (but as yet unappreciated)

"Rising prices have already encouraged us to do more prospecting and to exploit more of our lower grade deposits," Goode said.

"All our gold mining companies are busy assessing the possibilities of returning to so-called 'worked-out' areas, of opening up new adjacent areas or of prospecting other gold leaders above or below the present ore bodies."

Another possibility is the milling of stockpiled ore at the mines on Sundays, a move that might increase output on some properties by about 10 per cent without much additional investment.

changes in the outlook for the gold industry, and this Assoc. Press article gives some inkling regarding the newly emerging picture for the mines.

I am going to end this first section of the gold article with the comment that as in every other investment endeavor, purchase of gold shares will require patience before profits. Many of my subscribers now own Campbell Red Lake below 20 and ASA below 40. They already (I use those stocks merely as examples) have big paper profits. But I think the gold move will go much further (see next Letter). Primary movements, and the gold move is a primary move, require years to work out. The rises tend to be slow and labored, the corrections short and "scary."

Gold shares I like here at today's prices are East Driefontein, Vaal Reefs, Kloof (all rather new, long-life, big S. African

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mines which can be purchased via ADR's). I also like ASA, Campbell Red Lake, Sigma (controlled by Dome, as is Campbell). I have not really gone into the speculative gold mines such as Goldex, Agnico-Eagle, Little Long Lac, etc., but I will do so in the next mailing.

GREAT COINCIDENCES? In the Thirteenth century there lived in Asia a loose-knit and fierce group of people called the Mongols. The Persian historian, Juvaini, wrote of them that "Some of them regarded robbery, violence and debauchery as deeds of manliness and excellence." He wrote further, "Their clothing was of the skins of dogs and mice, and their food was the flesh of these animals and other dead things." But the Mongols had other qualities. They lived for horses and fighting; they were the greatest fighters the world had ever seen. They could shoot a quiver of arrows accurately at a full gallop, they could travel a week on horseback without a bite to eat. They were born soldiers, and they were feared by all who crossed their path.

In the Middle of the Thirteenth century, a Mongol king (and military genius) united all the Mongol tribes together and proceeded to sweep across Asia in a series of conquests that staggered the world. His name caused princes and kings to pale, it was Genghis Khan. Genghis, "The Great Khan," conquered all of Asia, laid down a book of law for all future Mongol generations, produced many sons, then died.

The sons of Genghis proved almost as fierce as their dreaded father. And they carried on his work of capturing the globe. By 1240 most of Russia had been subjugated. A Northern Mongol army captured Poland and Germany, a Southern army captured Hungary. Europe was next, and it shook before the "Mongol hoard." An English Chronicler wrote that "the detestable Mongols broke forth from their mountain-compacted region like devils loosed out of Hell...and like grasshoppers covering the face of the earth, spoiled the eastern confines with fire and sword, ruining cities, cutting up woods, killing people of both city and country..."

Europe was at the mercy of the fiercest, greatest fighting hoard the world had ever seen, and the sons of Genghis Khan prepared for the final surge into France, Spain, Scandinavia, England. But then, as though the earth had suddenly stopped on its axis — all was still. The horsemen who held the world by the throat turned around and quietly headed back to their homeland. Europe was stupefied. What had happened? The great Mongol king, Ogodai Khan, had suddenly died, and by Mongol law all the princes were required to return and meet for the election of a new king. Europe was saved, never again to face the terror of the swarming Mongol hoards.

On September 3, 1929, a speculation-crazed US watched as the Dow Industrials touched the unheard of peak of 381.21. Leading economists openly predicted that nothing could stop the stock market from its amazing rush to the stratosphere. Wall Street was occupying the time and minds of everyone, from waiters at New York's Pierre Hotel to members of the Presidential Cabinet. The "New Era" was an expression which was stamped into the American consciousness. The answer to the world's problems was at hand. Buy an American stock and "hang on, kiddo." A month later Wall Street was engulfed in history's worst market crash.

A year later all was in shambles, and reality was enveloping the land like a dark cloud. Not even a generation later, with the Dow at triple its 1929 high, was the euphoria of the 1920's fully recaptured. "The Great Crash" became a symbol. The world was never to forget it.

Few of today's "30-and-under" generation realize how close the Allies came to defeat at the hands of the modern scourge, Adolph Hitler. Nation by nation had been overrun by the Panzer divisions and the fearsome dive-bombers of the Third Reich. I remember the spring of 1942. Rommel had overrun Africa. The civilized world rocked as the legions of the Nazis smashed Europe's best armies. The collapse of France came so quickly it seemed like a one-week nightmare. The Dow Industrials, preparing for disaster, dropped to the famous April 28, 1942, low of 92.92. Hitler made two unbelievable "mistakes." He tried to bomb England out of existence, and he tried to overrun Russia (some say he did both on advice of his personal astrologers). The indomitable British airforce, flying around the clock, turned the mighty German airforce back. And the Russians, with the help of a brutal Asiatic winter, stopped the Germans amid horrendous losses on both sides. The tide of history had turned on two incomprehensible events, forged in the mind of a paranoid.

A remarkable series of events took place on June 17, 1972. An \$80-a-week security guard, a black man named Frank Willis, was checking the doors at the Watergate complex in Washington. He...well, here's the way the LA Times put it (at right):

He turned a knob on the No. 2 level and found that the locking mechanism had been pushed back with masking tape so it wouldn't catch: "I took the tape off but I didn't think anything of it. I thought maybe the building's engineer had done it."

Usually that door would not have been checked again for an hour, maybe longer, but for some reason — and Willis only smiles and shrugs again when asked why — he went back 15 minutes later and found the tape on again. "It seemed mighty suspicious, it being on there again that quick." So he called the police.

'Let Things Go . . . !'

Would the average guard have done that much? "Most likely they'd have let it go by," he says, smiling a nicely ironic smile. "That's mostly the attitude, to let things go. If I hadn't checked the doors, it would have been a gone thing."

Page 6 Then a second extraordinary event occurred. The alarm call from Wills found the marked police car that would normally have responded out being serviced. So an unmarked (!) car was sent out, thus foiling the lookout sentry posted by the Watergate conspirators. All were arrested in a matter of minutes.

That little incident set off one of the greatest political scandals and upheavals in American history. An Administration fabled for its "inner circle" aura, an Administration which had run on a "law and order" platform, came apart at the seams. A President who seemed extraordinarily powerful one moment, was, through the suspicions of a single intuitive security guard, reduced to fighting for his very political life.

I fancy myself a kind of student of history, and I read of the dramatic instances which change the course of history. "What have each of these instances got in common?" I ask myself. "What happened, and why did it happen?" I discuss it with friends and they tell me it is coincidence, it is merely a series of unconnected events leading to unexpected outcomes. I find that viewpoint hard to believe, and the longer I study, the more skeptical I grow of mere coincidence and chance.

I have my own simplistic theory. I have a theory that the powers above looked down on the Mongol hordes, on the roaring stock markets of 1929, on the advancing German armies, on the machinations of the politicians during the 1970's, and the powers said just one word, "Enough!"

STOCKS: In studying the various groups (I keep weekly relative strength charts of all groups), the following comprise the handful which are now showing superior relative strength. Aluminums, business machines, chemicals, cosmetics, drugs, glass, paper and of course the counter-cyclical golds. Remember, however, that a rising trend of relative strength means that the group is acting better than the market, but in a declining market these groups may merely be declining less rapidly than the market. However, when the market turns up the relative strength trend will usually continue, and it is then that the superior-acting relative strength groups will climb faster than the averages.

I show below the relative strength of the three components which make up the Transportation Average. Here it is interesting to note that all three groups are acting worse than the general market. Obviously, there is something wrong with the transportation picture. Could these groups be discounting a forthcoming contraction in activity? I would not bet against it, but at any rate a weak Transport Average (as all Dow Theorists know) is not a healthy omen for the market.

In the last Letter I showed a relative strength chart of Autos going back to 1912, with the 1973 major downward reversal. I was therefore not surprised to see the major auto stocks breaking to new lows this week. The auto industry, directly or indirectly, employs 1 out of every 6 workers in the US, so that even though not surprising, new lows on auto stocks are depressing. The chart below shows mighty GM at a new 1973 low, and its lowest level since 1970!

There are always a few stocks which I have my eye on, and in this case I have been watching American Can, Allied Chemical and Woolworth. All three act very resistant on the downside now, having suffered crushing losses in previous months. I include a chart of Can below (chart courtesy of Quote Digest, PO Box 213, Wichita, KS 67201). This is a stock that I would like to own when this market turns, and as we can see here, Can has stopped going down (it is now half its 1967 all-time peak of 54). So at least we have a place where our dollars have appreciated — namely, in terms of shares in American Can (look on the bright side, brother).

